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Turkey:
Two Years After the Stabilization Program

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An Intelligence Assessment

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July 1982

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An Intelligence Assessment

Information available as of 14 May 1982 has been used in the preparation of this report.

This assessment was prepared by [redacted] 25
[redacted] Western Europe Division, Office of European Analysis. It was coordinated with the National Intelligence Council. Comments and queries are welcome and may be addressed to the Chief, Iberia-Aegean Branch, EURA [redacted] 25X

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Turkey: Two Years After the Stabilization Program [redacted] 25

Key Judgments

In just two years Turkey has made substantial progress in restoring economic health—progress that should continue if the government adheres to present policies and if no major external shocks occur. The economic stabilization program begun in January 1980—and reinforced by the military after the coup the following September—has moved the Turkish economy toward an outward looking, free market system. In the process, the government has achieved major gains against soaring inflation and falling output and has halted the deterioration in the balance of payments. In short, last year clearly marked a turning point for the Turkish economy; increases in production, savings, exports, and invisible earnings and reductions in the trade deficit and inflation rate all exceeded even the usually optimistic government targets. [redacted] 25

The government's major success on the economic front has been the dramatic improvement in foreign exchange earnings. As a result of this improvement, there is a strong chance that Turkey can achieve balance-of-payments equilibrium in 1982 with little or no new program aid. Domestically, real GNP growth this year should match the substantial rise of last year, while inflation should continue to slow because of fairly stringent monetary and fiscal policies. [redacted] 25

Severe problems nonetheless remain. In particular, unemployment is likely to remain very high, and the State Economic Enterprises (SEEs) will continue to be a drain on scarce capital. Ankara will need to maintain restraints on domestic demand to make further progress in slowing inflation and reducing the trade deficit. Increased foreign exchange earnings will be necessary in the next few years to offset the end of IMF standby loan assistance in 1983 and the rise in interest payments as grace periods on rescheduled debt expire. In addition, the Turkish economy could still be sidetracked by developments such as a disruption of oil supplies or political upheavals in the Middle Eastern countries that recently have become major export markets for Ankara. [redacted] 25

Over the longer term, Turkey's economic prospects remain uncertain despite the country's considerable potential. Turkey has faced several economic crises in past years and responded successfully with stabilization programs, only to repeat earlier policy mistakes a few years after the recovery. The major test will come in 1984 after civilian rule is reestablished. The government then will come under increasing pressure from affected groups to restrict imports, control prices, cut taxes, increase spending, and so forth—which would reverse the progress made so far. [redacted] 25

[redacted] 25

Turkey: Two Years After the Stabilization Program [redacted] 25

From Crisis to Recovery

Turkey's economic problems reached a critical stage following the 1973/74 oil price hikes, which helped shift the current account from a $480 million surplus in 1973 to a $720 million deficit in 1974. Rather than allow the economy to adapt to the new environment, Ankara tried to shelter it with price controls, an overvalued exchange rate, and highly expansionary monetary and fiscal policies. By 1977 the government could no longer maintain these artificial conditions. The current account deficit had deteriorated to $3.4 billion—leading to a tenfold increase in short-term borrowing from foreign commercial banks. Turkey found itself unable to repay the loans or borrow additional funds and was forced to curtail imports sharply in 1978. [redacted]

In 1978 and 1979 the left-leaning Ecevit government implemented halfhearted stabilization programs and persuaded foreign commercial banks to reschedule Turkey's debts. It also negotiated a stabilization loan with the IMF and obtained aid pledges of more than $900 million from OECD governments. But Ecevit's approach did little to resolve Turkey's problems. The benefits from his one-time devaluation, for example, eroded within months as prices soared. By the end of 1979, the annual inflation rate had risen to 80 percent, shortages were proliferating, a black market was thriving, many homes were facing a heatless winter, and output and exports were stagnating. [redacted]

It was not until January 1980 that the new and more conservative Demirel government finally took the harsh measures necessary to stabilize the economy. These moves included a major devaluation of the lira (with a pledge to make additional devaluations as needed), a drastic reduction in subsidies to state enterprises, removal of price controls and some import restrictions, and increased incentives for exports and foreign investment. In a followup move in July 1980, Ankara abolished controls on interest rates. The stabilization program was reinforced by massive foreign assistance in 1980—the OECD pledged $1.16 billion in aid and rescheduled official debt, a three-year $1.6 billion standby agreement was signed with the IMF, and the World Bank added a $275 million dollar structural adjustment loan. [redacted] 25

Progress was evident by summer, although the economic recovery was being slowed by growing labor militancy, rising terrorism, and political immobility. Strikes and assassinations soared, while the deeply divided parliament was unable to act on important issues—including badly needed tax reform and the election of a new president. [redacted] 25

Reacting to these conditions, the military took control in September 1980. Among its first moves was a promise to continue the stabilization program and retain its author, Turgut Ozal, as Deputy Prime Minister for Economic Affairs. The military government then strengthened the economic recovery program by ordering strikers back to work, reforming the tax system, and imposing needed price hikes for state-produced goods. [redacted] 25 25

With strikes and shortages of oil and imported industrial goods virtually eliminated, output began to pick up in the fall of 1980. After having fallen for two years in a row, real GNP rose an estimated 4.3 percent in 1981, exceeding Ankara's target of 3 percent. While agricultural production rose only 0.4 percent, services were up 6.9 percent and manufacturing output jumped 9.1 percent. Led by a 54-percent surge in fertilizer production, overall industrial output came close to its 1978 peak. [redacted] 25 25

Serious Problems Remain

Despite the increase in industrial output, capacity utilization is still fairly low, particularly in the automobile sector. The excess capacity in turn is restraining fixed investment in manufacturing, which remains far below its 1977 level. The energy bottleneck—which included daily power outages—has eased, and with new power projects coming on line the situation should continue to improve. [redacted] 25

Construction is still depressed; building permits are down 16 percent from 1980 and 32 percent below the 1979 level. Turkish firms, however, have won a large number of building contracts in Middle East countries which [redacted] are worth more than $10 billion. These contracts boost business profits and the balance of payments, but of course they do not relieve the rapidly growing housing needs of Turkey's major cities. [redacted]

In the agricultural sector, Ankara is struggling to reverse past policies. During the 1970s misguided subsidy and price-support policies led to a poor mix of crops and inefficient use of fertilizer and mechanical inputs. Agriculture was particularly hard hit by the economic crisis as investment in the sector fell more than 50 percent in real terms between 1977 and 1980 and ambitious irrigation projects went unfinished. Beginning in 1980, Ankara has given agriculture higher priority in the investment plan, reduced the input subsidies, and tried to put the agricultural price-support system more in line with market forces. While much remains to be done, there has been some success, in improving efficiency: although fertilizer usage fell more than 20 percent last year, agricultural output still managed a slight increase. [redacted]

Unemployment and underemployment continue to be major problems in Turkey. While official figures put the unemployment rate at around 15 percent, it is probably closer to 20 percent. Employment probably rose about 1 percent over the last two years, and a significant number of Turks found work in OPEC countries, but job creation has lagged considerably behind the 2.5 percent annual growth of the labor force. The government will have to make more progress on problems that discourage job creation such as traditional labor militancy, restrictions on layoffs, and past government encouragement of capital-intensive development. Meanwhile, in the absence of a developed state welfare system, strong family ties provide support for the jobless. [redacted]

Turkish wage earners were hard hit by the soaring inflation rates of the late 1970s. Real wage rates for some workers have fallen as much as 50 percent since 1976, although this has been offset to some extent by bonuses, higher benefits, and the large tax cuts included in the tax reform bill last year. There is little prospect in the near term for an increase in real wages, as contract disputes are now being settled by a "supreme arbitration board" that currently is limiting increases to around 25 percent—the expected inflation rate this year. Low real wages should encourage more investment, particularly investment in labor-intensive activities, thus fostering the reduction of unemployment and promoting recovery. Civil servants have been budgeted a 25-percent raise this year, although higher increases are being granted for key positions in an effort to prevent talented managers from leaving for the private sector. [redacted]

Criticism of the stabilization program in the business community has come mostly from disgruntled businessmen complaining about high interest rates and the loss of protected markets. The doubling of the number of bankruptcies in 1981, which received wide play in the Turkish press, no doubt involved wrenching dislocations. Nevertheless, business failures appear to have been more than offset by new business ventures. [redacted]

Fiscal Policy on Track

One of the government's most important pieces of legislation in 1981 was the tax reform package. The first such reform since 1970, it reduced inequities and increased revenues by restoring progressivity to the tax system, broadening coverage, and improving collection procedures. Before the reform, nearly all wage earners had been pushed into the maximum 60-percent tax bracket by inflation. Wage earners were shouldering two-thirds of the total tax burden, although they accounted for only about one-third of total income. In addition to revising the personal income brackets, the government expanded coverage to include taxation of farmers and self-employed individuals for the first time. Corporate taxes were simplified and special breaks were provided for exporters. [redacted]

The reforms succeeded in reducing the fiscal deficit to $800 million—1.4 percent of GNP—from $2.4 billion in 1980, as tax revenues rose 59 percent. The government has enacted new tax cuts for this year on interest income and corporate earnings and plans to

lower personal income tax rates by 15 percentage points over the next three years. A value-added tax is being planned and could be implemented as early as 1983, although unsophisticated Turkish bookkeeping will hinder effective implementation. [redacted]

Ankara has managed to slow the growth of government expenditures as well, with spending dropping as a share of GNP from 28 percent in 1979 to 23 percent in 1981. The investment program has been pared to include only projects that can provide an economic return in the near future, and the government is giving priority to investments in energy, agriculture, and export projects. [redacted]

The State Economic Enterprises (SEEs), which contribute 30 percent of value-added in manufacturing, continue to be overstaffed and a drain on the budget. As part of the 1980 stabilization program, the government permitted most SEEs to set prices to cover costs and imposed limitations on the filling of job vacancies. The reported elimination of 21,000 positions reduced the share of labor in total costs from 23 percent in 1977 to 15 percent in 1981. This, along with price hikes, enabled the SEEs to turn a $15 million profit in 1981 on their operational accounts following losses of $300 million in 1980 and $2.3 billion in 1979. Nevertheless, on the investment accounts the SEEs still had a financing requirement of nearly $5 billion in 1981—8 percent of GNP—which was only a slight improvement over 1980. The SEEs have relied heavily on budget transfers and loans from the Central Bank to finance their investment program. [redacted]

Much more needs to be done to reform the state sector, and the government is preparing legislation to reorganize the SEEs to increase their efficiency and enable them to finance investments from their own resources. It has begun limiting direct access to Central Bank credits to all but one SEE—the agricultural purchasing agency—and has imposed cash limits on budget transfers. A lack of buyers combined with the etatist traditions dating to Ataturk—the founder of modern Turkey—make it unlikely that the government will act on suggestions to turn state industrial firms over to the private sector; nevertheless, it is lessening their drag on the economy by making them more responsive to market forces and ending their haphazard expansion. [redacted]

More Market-Oriented Monetary Policies

The freeing of interest rates in July 1980 has led to a more than sevenfold rise in time deposits. Interest rates on savings deposits, which previously had been held below the inflation rate, quickly rose to about 50 percent per annum, but major banks soon put together a "gentlemen's agreement" to keep rates from rising further. Current rates remain at about 50 percent, well above the inflation rate, and provide a positive real return on savings for the first time in years. General loan rates reportedly exceed 50 percent when taxes and fees are added in, but preferential rates on export and agricultural credits are considerably lower. The large pool of savings may permit a drop in lending rates and an increase in investment later this year. [redacted]

Liberalization of the money markets led to a proliferation of nonbank financial institutions—referred to as "money brokers"—which, not subject to bank reserve requirements, were offering returns of over 100 percent per annum by selling discounted certificates of deposit. These firms attracted a lot of business, leading the established banks to clamor for restrictions on them. The matter was poorly handled last fall by the Finance Ministry, which announced a series of piecemeal decrees that frightened depositors and led to a panic. Premature withdrawals precipitated a number of bankruptcies among the weaker money brokers. [redacted]

In response to this crisis and to a rapid expansion of established banks, Ankara imposed a new capital market law, which should consolidate the banking sector. The new law requires money brokers to adhere to regulations governing banks, sharply increases the capital requirements of banks—the amount rises with the number of a bank's branches—and restricts the number of branches that foreign banks can open. [redacted]

Despite the turmoil in the money markets, the Turkish Central Bank has brought expansion of the money supply under control. M1 growth fell from close to 60 percent in 1980 to about 23 percent last year.[1] M2

[1] M1 is a monetary aggregate comprising currency in circulation plus demand deposits, while M2 includes these categories plus savings deposits. [redacted]

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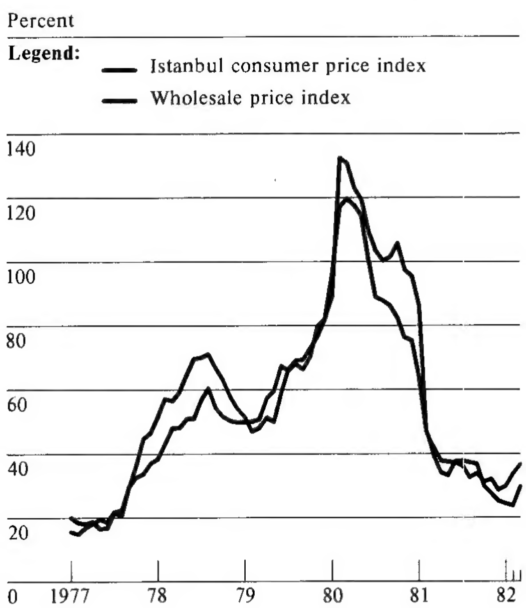
Figure 1
Turkey: Consumer and Wholesale Prices[a]



[a]Change from 12 months earlier.

[redacted]

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grew much faster in 1981—about 60 percent—because of the sharp rise in savings deposits, but the illiquidity of most of the time deposits probably makes M1 more relevant. Central Bank credit growth has slowed, and lending has been shifted increasingly to the private sector over the past year as the public-sector deficit was brought under control. [redacted]

Tighter fiscal and monetary policies have brought considerable success in the fight against inflation. Despite the inadequacies of Turkish price indexes, the relative trend is unmistakable (see figure 1). Consumer and wholesale price inflation—at triple-digit rates in early 1980—slowed last year to 25-30 percent (December over December). This performance is especially impressive considering the lira's devaluations and public-sector price hikes. The 1982 goal of 25-percent inflation may still be attainable, although Turkey got off to a bad start in the first quarter with state-sector price hikes causing wholesale prices to rise at about a 40-percent annual rate. [redacted] 25X

Competitve Exchange Rate Maintained

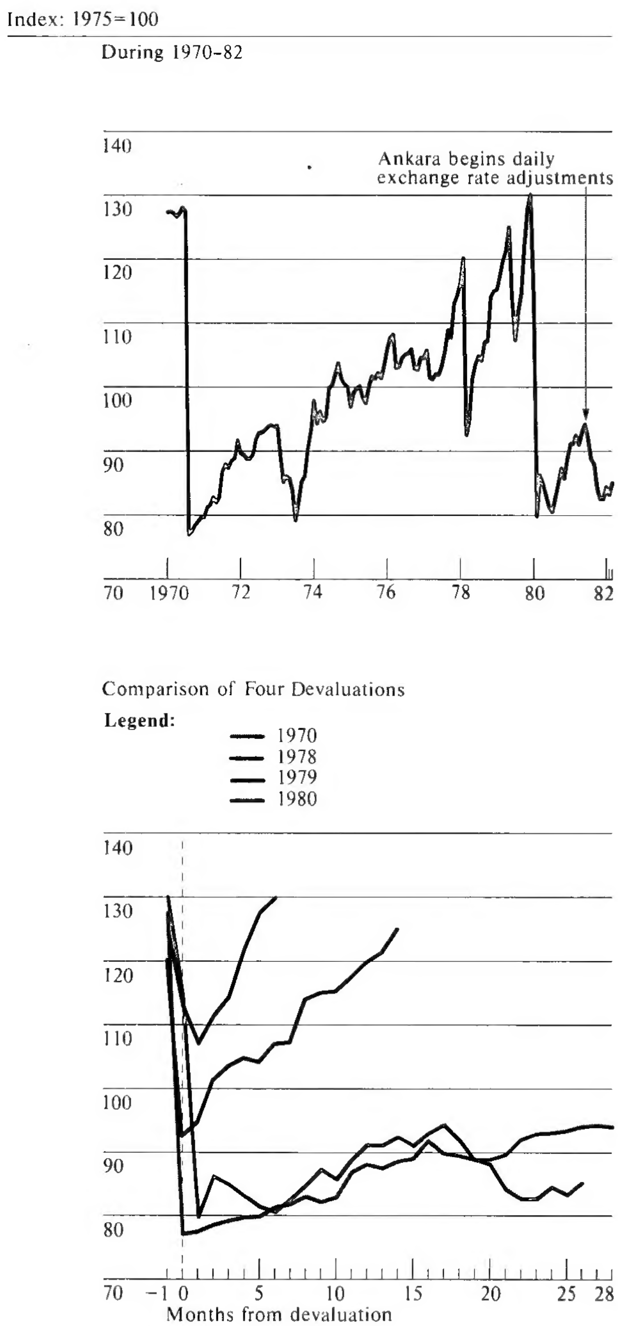
The most dramatic economic improvement has been in the balance of payments, and the central factor in restoring payments equilibrium has been Ankara's exchange rate policy. The major devaluation in January 1980 brought the lira to a realistic level, but during the following year or so the situation deteriorated somewhat as additional devaluations failed to compensate fully for the inflation differential between Turkey and its trading partners. Last May, however, the government began making small daily exchange rate adjustments, enabling it to accelerate the lira's depreciation without attracting the attention given to earlier sporadic devaluations (see figure 2). This practice must be maintained if Turkey is going to sustain its improvement in foreign exchange earnings. [redacted] 25X

Exports Booming

Turkey has embarked on a vigorous export drive aided by realistic exchange rate policies, weakened domestic demand, and such export incentives as tax breaks, interest rate subsidies, and foreign exchange retention rights. Exports rose nearly 30 percent from $2.3 billion in 1979 to $2.9 billion in 1980, then soared more than 60 percent to $4.7 billion last year, easily surpassing Ankara's export target of $3.8 billion. The quick response to the new market environment by traditionally inward-looking Turkish business people is encouraging for the future of the recovery effort. [redacted] 25X 25X

The biggest gains occurred in sales to the Middle East, where exports have risen fivefold since 1979 and the share of Turkish foreign sales has increased from less than 20 percent to about 40 percent. The single largest gain was in Libya, with exports up over 600 percent in 1981. Payment problems cropped up because of Libyan bureaucratic and cash flow difficulties, but future payments can be covered by Libyan oil exports to Turkey. Turkey has yet to reach its export growth potential in the Middle East, despite declining oil revenues in some OPEC countries. Ankara's market share is still very small—Turkish goods comprise 25X

Figure 2
Turkey: Lira Exchange Rate Index[a]



[a]Trade-weighted and price adjusted.

[redacted]

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no more than 5 percent of the total imports of any Middle East trade partner—and most payments could be covered by Turkish oil imports. Although Turkey's growing dependence on Middle East markets clearly makes it vulnerable to instability in the area, Turkish exports to these countries consist primarily of foodstuffs, agricultural equipment, and basic capital goods, none of which would be an easy target for retrenchment policies. Further, Turkey's Islamic heritage and geographic proximity should continue to work in its favor. [redacted] 25

Exports to the OECD rose an impressive 35 percent despite sluggish import demand in the developed countries (see table 1). Exports to the United States and Switzerland more than doubled while sales to the European Community rose more than 20 percent. The biggest gains came in agroindustrial goods, textiles, and cement. Meanwhile, exports to East European countries fell nearly 60 percent, reducing their share in Turkish exports to under 3 percent. A major Turkish concern is growing EC protectionism; the Community imposed antidumping levies on Turkish raisins and yarn late last year and recently voted to continue restrictions on yarn. The protectionist measures appear to have hurt these important exports; in the first two months of 1982, raisin exports were down about 25 percent from year-earlier levels and cotton yarn sales were off 5 percent. [redacted] 25

The shift in commodity composition of Turkey's exports has been encouraging, with industrial exports more than doubling last year and surpassing agricultural exports in value for the first time. Agricultural exports could not respond as quickly but still increased by one-third in 1981 (see table 2). The growth in agricultural exports may have been impeded by export levies on some key crops and by the stockpiling of wheat by dealers hoping for an increase in the support price. Exports of foodstuffs should accelerate this year, particularly to Middle Eastern markets. High-level Turkish visits early this year to Iran, Iraq, Jordan, and Kuwait resulted in calls for increased imports of Turkish goods. [redacted] 25

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Table 1

Turkey: Trade by Countries [a]

	Value of Exports (Million US $)		Percent Change	Share in Total Exports (Percent)		Imports (Million US $)		Percent Change	Share in Total Imports (Percent)	
	1980	1981		1980	1981	1980	1981		1980	1981
Total	**2,910.1**	**4,702.9**	**61.6**	**100**	**100**	**7,909.4**	**8,933.0**	**12.9**	**100**	**100**
OECD	1,679.7	2,263.7	34.8	57.7	48.1	3,583.4	4,279.5	19.4	45.3	47.9
EC	1,242.1	1,502.9	21.0	42.7	31.9	2,267.8	2,519.5	11.1	28.7	28.2
West Germany	604.0	643.2	6.5	20.8	13.7	837.5	939.9	12.2	10.6	10.5
France	163.9	215.7	31.6	5.6	4.6	376.6	400.0	6.2	4.8	4.5
Italy	218.4	246.1	12.7	7.5	5.2	299.7	372.0	24.1	3.8	4.2
UK	104.5	148.0	41.6	3.6	3.1	316.8	433.7	36.9	4.0	4.9
Other EC	151.3	249.9	65.2	5.2	5.3	437.2	373.9	−14.5	5.5	4.2
United States	127.4	267.9	110.3	4.3	5.7	442.4	589.4	33.2	5.6	6.6
Switzerland	125.4	263.7	110.3	4.3	5.6	347.6	532.9	53.3	4.4	6.0
Other OECD	184.8	229.2	24.0	6.4	4.9	525.6	637.7	21.3	6.6	7.1
Communist	490.6	326.9	−33.4	16.9	7.0	757.4	796.1	5.1	9.6	8.9
USSR	169.0	193.7	14.6	5.8	4.1	180.7	163.6	−9.5	2.3	1.8
Eastern Europe	321.6	133.2	−58.6	11.1	2.8	576.7	632.5	9.7	7.3	7.1
Middle East	622.9	1,886.2	202.8	21.4	40.1	3,055.6	3,400.6	11.3	38.6	38.1
Iraq	134.8	559.0	314.7	4.6	11.9	1,237.3	1,564.0	26.4	15.6	17.5
Iran	84.8	233.7	175.6	2.9	5.0	802.5	515.0	−35.8	10.1	5.8
Libya	60.3	441.5	632.2	2.1	9.4	778.4	788.3	1.3	9.8	8.8
Saudi Arabia	43.6	187.4	329.8	1.5	4.0	105.8	410.0	287.5	1.3	4.6
Other Middle East	299.4	464.6	55.2	10.3	9.9	131.6	123.3	−6.3	1.7	1.4
Other	116.9	226.1	93.4	4.0	4.8	513.0	456.8	−11.0	6.5	5.1

[a] Because of rounding, components may not add to the totals.

[redacted] 25X

Turkish exports should be more than 15 percent higher this year at around $5.5 billion.[2] On a seasonally adjusted basis exports were actually running at a $5.8 billion annual rate in the fourth quarter of last year, but slowed markedly in the first quarter of this year (see figure 3). Other export forecasts—which do not take into account the first-quarter seasonally adjusted decline—range from the $5.85 billion projected by the IMF and the OECD to the optimistic $6.5 billion anticipated by Turgut Ozal. [redacted] 25X

Even with Turkey's excellent performance last year, exports still amounted to only 8 percent of GNP. Inadequate marketing and storage facilities and underdeveloped transportation infrastructure could be important long-run impediments to exports; ports, railheads, and border-crossing points now are congested with goods bound for Iran and Iraq. Ankara has

[2] This is a conservative figure based on recent trends. It assumes continued incentives for exports including a competitive exchange rate as well as interest and tax subsidies. It also assumes no sharp change in import demand from OECD or Middle East countries. Exports are unlikely to approach the 1981 rate of increase because of physical limitations in productive capacity and export infrastructure. [redacted] 25X

Table 2

Turkey: Commodity Composition of Trade [a]

	Value (Million US $)		Percent Change	Share in Total (Percent)	
	1980	1981		1980	1981
Exports	**2,910.1**	**4,702.9**	**61.6**	**100**	**100**
Agricultural	1,671.7	2,219.4	32.8	57.4	47.2
Cereals	80.4	110.4	37.3	2.8	2.3
Industrial crops	583.1	744.6	27.7	20.0	15.8
Fruits and vegetables	753.9	795.1	5.5	25.9	16.9
Other	254.3	569.3	123.9	8.7	12.1
Minerals	191.0	193.4	1.3	6.6	4.1
Industrial	1,047.4	2,290.1	118.6	36.0	48.7
Agroindustrial	209.4	411.7	96.6	7.2	8.8
Petroleum Products	38.5	107.0	177.9	1.3	2.3
Textiles	424.3	820.8	93.4	14.6	17.5
Other manufacturing goods	375.2	950.6	153.4	12.9	20.2
Imports	**7,909.4**	**8,933.0**	**12.9**	**100**	**100**
Agriculture	49.8	125.0	151.0	0.6	1.4
Minerals and fuels	4,005.7	4,098.3	2.3	50.6	45.9
Crude oil	2,952.2	3,257.0	10.3	37.3	36.5
Petroleum products	909.8	620.7	−31.8	11.5	6.9
Other	143.7	220.6	53.5	1.8	2.5
Industrial	3,759.1	4,640.7	23.5	47.5	52.0
Chemicals	1,121.7	1,198.9	6.9	14.2	13.4
Iron and steel	462.5	604.7	30.7	5.8	6.8
Machinery	842.4	1,222.8	45.2	10.7	13.7
Other	1,332.5	1,614.3	21.1	16.8	18.1
Imports with waiver	94.8	69.0	−27.2	1.2	0.8

[a] Because of rounding, components may not add to the totals.

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moved to increase incentives and to simplify export procedures further, and exporters are still lobbying for an export insurance system. We, along with the IMF and other foreign observers, believe that the government eventually will have to wean exporters from a costly incentive program and rely more on exchange rate policies to maintain competitiveness.

Imports Resume Growth

Imports soared 56 percent in 1980 as the foreign exchange shortage eased, but last year rose only 13 percent to $8.9 billion. The sharp jump in 1980 came largely in higher oil imports as the oil bill rose from $1.7 billion in 1979 to $3.9 billion in 1980. The volume of imports of crude oil and petroleum products, after falling for two years, rose 27 percent in 1980 to 15.8 million tons (316,000 b/d), some of which went to rebuild stocks. With stocks built up and higher prices encouraging conservation, oil import volume fell 12 percent in 1981 to 13.9 million tons (278,000 b/d). The average price per barrel rose about 13 percent to $38, so the oil import bill was unchanged at about $3.9 billion.

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Figure 3
Turkey: Imports, Exports, and Worker Remittances[a]

[a]Seasonally adjusted quarterly data at an annual rate.
[b]1st quarter 1982 are estimates.

[redacted]

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Domestic oil prices have jumped since 1980 because of the devaluations of the lira, the increase in administered prices to world levels, and the doubling of OPEC prices in 1979/80. Higher domestic prices should encourage movement toward a lower oil/GNP ratio—the experience in other countries—and possibly toward reduced oil imports. With the softening of the oil market this year, the oil import bill should decline. Assuming no change in oil import volume and a drop in price to $34 per barrel, Turkey's oil bill will be about $3.4 billion. [redacted]

Nonoil imports soared in 1981, rising about 25 percent in dollar terms to nearly $5.1 billion. In volume, nonoil imports may have risen as much as 35 to 40 percent because export prices of Turkey's main Western trading partners dropped roughly 8 to 10 percent last year in dollars. This would put real imports close to the level of 1976-77. The import trend slowed toward the end of the year, and with stocks now largely rebuilt, nonoil import volume should rise less than 15 percent this year, even with the planned further liberalization of import regulations.[3] Assuming the US dollar holds steady against other major currencies and nonoil import prices rise 6 percent, nonoil imports could reach $6.1 billion and total imports $9.5 billion. Forecasts must be tentative because Turkish trade statistics are subject to major revisions—1980 imports were revised upwards by $1 billion last spring and another $240 million early this year. [redacted]

Invisible Earnings Accelerating

The above forecasts yield a trade deficit of $4.0 billion, down from $4.2 billion last year and $5.0 billion in 1980. Most of the shortfall will be covered by increased invisible earnings, of which the largest category is remittances from the more than 1 million Turks working abroad. Worker remittances rose sharply after the inauguration of the 1980 stabilization program in response to the lira devaluation, the freeing of interest rates, and the improved economic and political stability in Turkey. After having stagnated for several years at around $1 billion, remittances climbed to $2.1 billion in 1980 and $2.5 billion in 1981. The dollar value of the increase would have been even greater if the West German mark (the currency of the majority of remittances) had not fallen so sharply against the dollar. Remittances in deutsche mark terms rose over 50 percent in 1981 compared to a 20-percent rise in dollar terms. With a neutral exchange rate assumption for 1982, remittances are expected to be up about 12 percent to $2.8 billion, largely because of the increased number of Turks working in the Middle East on construction projects.[4] [redacted]

[3] The slower projected rate of growth of nonoil imports is based on the trend in late 1981 and early 1982 and the expectation that domestic consumption will continue to be flat this year. Although import elasticities have shown no consistent pattern in past years, a 16-percent volume rise in nonoil imports should easily permit a 4.5-percent rise in GNP and a 15-percent rise in exports. [redacted]

[4] This projection assumes that the number of Turks in Western Europe will remain stable while another 50,000 find work in the Middle East (about 14,000 workers went abroad in the first quarter of this year). Estimates vary but Turkish workers in the Middle East may remit $5,000 to $6,000 each, thus providing $300 million more in remittances than last year. Remittances from Western Europe should be flat because higher wages will be offset by increased unemployment among the Turkish population there. [redacted]

Outflows for interest payments should be approximately $1.45 billion this year (before debt relief), unchanged from 1981. With a favorable exchange rate and continued civil calm, net tourism receipts could approach last year's 30-percent rise to reach $350 million. Tourism continues to have great longer run potential, but sizable investments are needed to attract and accommodate visitors. Net receipts in the "other invisibles" category more than tripled in 1981, exceeding $560 million, apparently because of increased receipts from contracting in Arab countries. Turkish construction firms have gained a strong foothold in the Middle East, and business generated from existing and future projects promises to become a major source of foreign exchange and jobs for the Turks. The reported $10 billion worth of building contracts signed in the last two years probably represents some "overbooking," and Libya, which reportedly has contracted for $7 billion of the business, may be unable to complete all the contracts because of revenue problems. Still, with a continuing rise in contracting earnings, plus transit fees from the large volume of goods passing through Turkey to Iran and Iraq, "other invisibles" should continue to rise rapidly, reaching perhaps $800 million this year. Thus, the invisibles balance before debt relief (interest debt relief is included in the capital account) is expected to run a surplus of $2.5 billion this year, up from $1.9 billion last year and $1.3 billion in 1980. The projected current account deficit of $1.5 billion compares favorably with the $2.3 billion experienced in 1981 and $3.7 billion in 1980. [redacted]

Capital Account Inflows To Close Gap

Capital account inflows are difficult to pin down, but credits and aid already in the pipeline should be sufficient to cover the current account deficit (see table 3). A net of $320 million is expected from the IMF in 1982 under the three-year standby agreement. World Bank and other project loans should total $760 million, while perhaps $400 million in outstanding 1981 OECD pledges (including $200 million of the US pledge released in January) will be available this year. Debt relief will provide $550 million, and private foreign capital should reach $200 million. Euroloans and loans from the Middle East that already have been arranged may provide about $400 million more. Capital outflows are likely to consist mainly of debt repayments of $1.4 billion. The capital account surplus, including IMF drawings, is projected to total about $1.5 billion, offsetting the current account deficit without considering possible fresh loans or aid. [redacted] 25

Although no estimate of errors and omissions is included in our balance-of-payments forecast, this could be an important additional source of foreign exchange in 1982; net inflows in this category exceeded $1.1 billion in each of the last two years. [redacted] 25

Outlook for New Aid and Loans

If our payments projections prove accurate, Turkey will achieve balance-of-payments equilibrium in 1982 without significant new aid. The OECD aid-pledging group, which has provided Turkey with close to $1 billion per year in pledges since 1979, was expected to meet this spring, but the session was postponed because of political sensitivities about Ankara's military regime in some West European countries and Turkey's improved balance of payments. Denmark and Norway have already frozen disbursement of their 1981 pledges, and the EC has suspended its fourth financial protocol to Turkey—worth some $600 million over the next five years. Other countries—West Germany most importantly—have encountered parliamentary opposition to providing economic support to the military government. [redacted] 25

The prospects for a pledging session later in the year 25
are uncertain. OECD consortium head Rolf Gerberth has proposed an alternative involving a meeting of OECD representatives to discuss Turkey's economic situation but no formal pledge announcements. Aid could then be proposed later on a lower key, bilateral basis. [redacted] 25

According to OECD officials, Turgut Ozal favors a formal pledging session. Nevertheless, we believe that Ankara would probably accept a less formal alternative because it wants to avoid providing smaller OECD countries, whose aid contributions are relatively low in any case, with another opportunity to speak

Table 3 Million US$

Balance of Payments

	1980	1981 [a]	1982 Official Projection [b]	1982 CIA Projection
Current account	**−3,680**	**−2,342**	**−1,800**	**−1,500**
Trade balance	**−4,999**	**−4,230**	**−4,150**	**−4,000**
Exports	2,910	4,703	5,850	5,500
Imports	−7,909 [c]	−8,933	−10,000	−9,500
Oil	3,862 [c]	3,877	4,310	3,400
Nonoil	4,047	5,056	5,690	6,100
Invisibles	**1,319**	**1,888**	**2,350**	**2,500**
Worker remittances	2,071	2,490	2,850	2,800
Interest (before debt relief)	−1,138	−1,443	−1,450	−1,450
Tourism	212	277	350	350
Other	174	564	600	800
Capital account	**2,342**	**1,129**	**1,135**	**1,210** [d]
Private foreign capital	148	129	235	200
Debt repayment before debt relief	−1,556	−1,185	−1,400	−1,400
Debt relief	1,450	850	550	550
Interest	470	250	100	100
Principal	980	600	450	450
Project and suppliers' credits	547	642	850	760
Program credits	1,811	840	900	1,100
OECD	996	354	400	400
IBRD structural adjustment loan	250	325	300	300
Other	565	161	200	400
Acceptance credits	−58	−147		
Overall Balance	**−1,338**	**−1,213**	**−665**	**−290**
IMF	461	335	320	320
Deficit/surplus	**−877**	**−878**	**−345**	**30**
Change in reserves	333	58		
Short-term capital	155	213		
Errors and omissions	1,365	1,149		

[a] Estimated.
[b] Projections made by Ankara with concurrence by OECD and IMF are as of January 1982 and were based on 1981 export estimates of only $4.5 billion.
[c] Revised upward in February by $240 million (previously unrecorded oil imports).
[d] Including only aid and loans already arranged.

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out against the military in an international forum. The Turks would welcome bilateral aid—provided no political costs were involved—particularly if oriented toward infrastructure and energy development projects. Additional grants and loans obviously would provide a margin of safety for Turkey in case of unforeseen adverse developments. [redacted]

The balance-of-payments improvement and the US proposal for $350 million in new economic aid this year could provide other OECD donors with an excuse not to push the politically sensitive issue of new aid to Turkey. Aid will come from other sources, however. The World Bank has agreed to another $300 million structural adjustment loan and will supply new project credits. The recent high-level Turkish visits to Middle Eastern countries reportedly resulted in agreements to provide more capital through increased investments and joint ventures. Further, Turkey will receive $60 million from the Kuwait Development Fund, $46 million from the Islamic Development Bank, and $200 million from the Arab Banking Corporation according to press reports. [redacted]

Turkey is engaging in commercial borrowing on the Euromarket this year for the first time since 1979. So far this year Turkey reportedly has arranged syndicated loans for aircraft purchases ($75 million) and construction projects ($77 million). According to *Euromoney* and *Institutional Investor,* Turkey was one of the few countries whose creditworthiness improved in 1981 although its rating is still low. Turkey could encounter some reluctance among bankers still smarting from two reschedulings of Turkish bank debt in the last three years. Turkey may have done itself a disservice by pushing for the second rescheduling— [redacted] rather than holding off until it could get new commercial loans. [redacted]

Ankara probably needs to be more aggressive in attracting private foreign investment to provide Turkey with jobs and Western technology. On paper such inflows registered a big increase in 1981 but very little capital actually entered the country. Most of the reported inflows represented repayment of overdue foreign commercial debts. The payments were made in liras and the money had to be invested in Turkey. [redacted]

Policy Prospects

Ankara has clearly taken a big step toward making the economy responsive to supply and demand forces, but Turkey is still a long way from being a basically free enterprise economy. Government intervention remains widespread, the SEEs are still too large, wages are not freely determined, and exports are 25
subsidized. In addition, Ankara retreated somewhat from its liberalization of the banking sector with the new capital market law and seems to be encouraging the "gentlemen's agreement" among banks. [redacted] 25

Turgut Ozal has said publicly that he wants to keep Turkey moving cautiously—but steadily—on its course toward a market-oriented economy. Nevertheless, the return of civilian rule in late 1983 or early 1984 will bring increased pressures for renewed expansionary and interventionist measures that would jeopardize sustained economic improvement. Inflationary monetary and fiscal policies, an overvalued exchange rate, and reliance on statist solutions have triggered economic crises three times in the last 30 years. Although the current stabilization program 25
appears to go further than previous ones, particularly in its approach to fundamental problems of the exchange rate and the state sector, there is still ample leeway for Turkish policymakers to repeat past mistakes. [redacted] 25

Even a civilian administration with stronger constitutional powers than past ones had will be hard pressed to ignore criticism from labor, consumers, and some sectors of the business community who are tired of belt tightening. The success of the stabilization program will be a strong example for future governments, but with the most pressing problems behind them, civilian leaders may look for expedient ways to 25X
accelerate Turkey's development and try to reduce 25
unemployment through inflationary policies. Although the chances for a continuation of wiser policies are better as long as Turgut Ozal remains the chief economic policymaker, even he might eventually bow to pressure to ease monetary and fiscal restraints to ease the unemployment problem. If Ozal is removed, foreign investors and bankers would again become doubtful about Turkey's economic outlook, and opponents of his policies would have less trouble reversing them. [redacted] 25